

Alternate Power Source (APS) is taking this opportunity to comment on the Department's Proposed Rulemaking dated May 1, pursuant to 220 c.m.r. para. 2.00 et seq. establishing the procedures to be followed in electric industry restructuring by electric companies subject to G.L. c.164.

Before submitting our comments and/or alternative proposals, we would like to add a few words about our Company personnel. Most of our members have had senior management experience within the electric utility industry, particularly within this region for a number of years. What is unique about their background is that they represented fuel supply and power supply interests within the industry and have first hand knowledge about restructuring of other industries, especially gas and transportation. We hope to share that experience with you as you make your momentous decisions in the weeks and months ahead. And, we want to share that experience with you not so much because it's nostalgic but because there have been many lessons learned along the way concerning this most challenging task.

One idea stands out above all the rest: "the market, no matter how imperfect it is, is still the best arbitrator". While there is no one best way to establish a flawless competitive market, we believe that opening the market through a pilot program similar to the DOER suggestion is germane to its successful implementation. Consumer interests will be best served if they are introduced to the market through "real" market experience. Leaving that experience to opening day 1/1/98 will lead to confusion, possible resentment and interim loss of economic value to the ratepayers of Massachusetts who could participate in a pilot. The Commonwealth can ill afford to be waylaid. Prudence would indicate that the Department use this interim period to smooth the 1-1-98 transition period. The best way to do this in our opinion is to provide a one year pilot beginning on 1-1-97 in spite of the objections of the utilities. It has been both stated and written on numerous occasions by the utilities themselves that they look forward to entering this new competitive environment. A one year pilot program would allow them the opportunity to gain experience in this competitive market place, in which they savor to participate.

Let's not leave the end result to speculation and conjecture about what may be 19 months ahead. It will distort the market and send out the wrong signals to all stakeholders. We will discuss this issue, and lay out our alternative, later on.

Now to our comments and suggestions pertaining to the Departments Proposed Rulemaking. We intend to cover the proposed areas in step with the agenda laid out in the Departments Table of Contents. Those areas which we wish to comment upon are:

Executive Summary Issues

- The Independent System Operator
- Power Exchange
- Corporate Structure
- Horizontal Market Power
- Load Aggregators
- Environmental Issues
- Distribution Franchise
- Transition and BECo Proxy Price
- Stranded Costs
- Performance Based Regulation

And, we would strongly urge the Department to include:

A Pilot Program

A mandated open access information system to regulated entities.

- Independent Billing and Metering Services to assure fair dealing.

In the Executive Summary, the Department posed a number of questions concerning the role of the Distribution Company, the credentials of suppliers, stranded cost coupled to market power concerns and possible environmental impacts which may result from restructuring. Our thoughts on these areas are:

Executive Summary Issues

Distribution Company:

The Distribution Company must be required to keep a "hands off" policy towards its customers. If functional unbundling is the choice, and we hope it is not, we can expect the likelihood of self-dealing. Functional unbundling, no matter how well devised to thwart anti-

competitive behavior, will not work. The only remedy is complete separation. So long as there is one CEO over all the functions, and as long as that CEO is required to maximize economic benefits to the shareholders, the bottom line will only be enhanced through cross-optimization of all the component functions (companies). APS therefore urges the Department to rule in favor of allowing only non Distribution linked generation suppliers to provide energy services. For those Distribution Companies that retain generation we suggest that the generation affiliate only be allowed to sell into the PE.

**Supplier Registration Requirements:**

As a small energy broker/marketer, APS is concerned with the creation of barriers that will stifle the experienced company who does not have deep corporate pockets. FERC's position is that all marketers are to be treated equally, irrespective of size. Limiting the number of entrants restricts the market and can lead to market power abuse. The Department may want to certify suppliers for piece of mind but we must state that there is no fail safe way to determine the quality of any supplier irrespective of size. Finally, the State already has a means to cull out companies who undertake questionable supply practices. We believe that this is the forum to address this issue.

**Sale of Generator Assets:**

As long as assets remain under the control of one Corporate entity, the price charged for their services will not be market based. APS therefore believes that dispersion of assets through sale or spin-off should be required in a supervised orderly manner. Competition among different owners of similar assets provides the greatest benefit and protection for customers. The Department should make it not worthwhile for vertically integrated utilities to retain generation assets if they wish to remain in the Distribution business. From our perspective, the customer has as much right to the assets as the local franchise holder. After all, it was paid for through high utility rates as a result of a guarantee on investment returns. To level the playing field, and in the interest of not taking the track to litigation, we propose that all assets be sold at an auction during a specified period of time. Or, operational control of the assets should be vested in a non related enterprise. A lease arrangement could be worked out for those who wish to continue in the generation business. We strongly believe that the only way to handle both stranded costs and market power is through diminution of assets and pay back to the customer of funds collected or through a minimal stranded cost surcharge shared equally by the stakeholders. From review of the FERC-1 forms, we believe that those charges should not exceed 1.0 cents per kilowatt hour over a ten year period. We support the DOER position on this issue and ask that the Department request the utility interests to put up the "for sale" sign.

**Environmental Impacts:**

We believe that State statutes, properly enforced, will have no appreciable impact on the environment due to restructuring. All investment decisions will be made under assumed environmental standards and be priced accordingly.

### The Independent System Operator

APS believes that a new arrangement must be made with an entity that does not have the same close affiliation with its member companies. We restate our position which is found on page 6 in our comments on restructuring proposals dated April, 12, namely: "We believe that it is not possible for NEPOOL to be an independent system operator that is totally independent of those which helped create it". Furthermore, we state that " There is no need to remind outsiders that the obligations and loyalties of NEPOOL management run deep, and so do their roots." Should NEPOOL remain as it is, no matter the purported name change or different membership arrangement, there will be market power over Regional dispatch. On Page 187 of FERC MEGA NOPR the FERC addresses the issue of "Tight Power Pools" by mandating that "The Commission...will require that the public utility members of tight pools file reformed power pooling agreements no later than December 31, 1996. The reformed power pool agreements should establish open, non-discriminatory membership provisions (including establishment of an ISO, if that is a pool's preferred method of remedying undue discrimination)..." The edict of FERC is not as clear cut as we would like and without resolution of market power concerns there will be discriminatory market practices. FERC is aware of market power concerns but appears at a loss in proving market power influence. Therefore, FERC will not use market power as the basis for requiring the formation of an ISO. And, we are aware that transmission is under the aegis of FERC. However, we believe that FERC will rule for true independence if a meaningful case is made to FERC. We support the Departments efforts to create an independent entity and believe that the overwhelming majority of stakeholders support that view.

### Corporate Structure

As stated in our Comments on Five Restructuring Proposals pages 4-6, Corporations must be restructured in order to reform the industry. Under functional separation, the effective dispersion of current market powers will be very difficult to achieve. We need not remind the Department that "New England Electric System and Northeast Utilities operate substantive intrastate electricity transmission lines on north-south and east-west axes (p.5 - DPU 95-30) and Eastern Edison has stated that "the big three control over 70% of the Massachusetts market and Northeast controls over 68% of uncommitted generation capacity (p.8 - Testimony) and NEES admits that "NU has 35% of all regional capacity" (p.119). Accordingly, the Department should make it perfectly clear that its choice is for Corporate restructuring along the lines of the Div. of Energy "Power Choice" Plan (p.23ff.) and that incentives or disincentives should be offered to make that choice. We are also not for litigation but the Department may wish to consider the consequences of utility non-compliance with the restructuring plan, particularly in a timely manner.

### Load Aggregators

As we explained previously, the Department should not set up barriers to new market entrants for it would become a restraint of trade. As with other products or services there are avenues which can be taken which will address this potential problem in a satisfactory manner.

### Environmental Issues

The Department requested comments on the following question (p.39): Would it be feasible to implement a policy whereby an existing generating unit would be required to achieve compliance with new source performance standards within three years of its original retirement date if it will operate past that date? What costs would be involved? What would the role of the Department be in supporting relevant environmental agencies in implementing such an approach? ---- To require an older generating unit to achieve compliance with new source performance standards will be challenged in the courts, will lead to shutdown or substantial increases in either fuel costs, equipment costs or plant modifications. It is unrealistic to open the generation market to competition on the one hand and then strap it with unreasonable costs. Savings to customers could be dramatically impacted as a result of such actions, and the Department would be replacing one form of regulation with another. Such action runs counter to the Department's intent to create a competitive market where price will be the criteria for all generation decisions. As mentioned previously, existing

environmental statutes properly enforced is adequate to protect the environment.

### Distribution Franchise

On page 42 the Department solicits responses to the following questions:

Should a prohibition against Distribution Companies owning generation directly apply to small-scale generation delivering power of distribution-level voltage owned for the purpose of avoiding distribution system upgrade costs (i.e., distributed generation)? --- Our response is no. Avoiding distribution system upgrade costs directly benefits all customers by keeping rates lower.

Should distributed generation be supplied by the Distribution Companies or through competitive means? ---- Our response is that it should be supplied through competitive means. It lends a credibility check to distribution system costs.

Can distributed generation be supplied by both Distribution Companies and competitive entities? ---- Our response is yes.

Which functions of a Distribution Company should remain within the scope of a monopoly franchise and which are more appropriately provided by competitive markets? ---- Our response:

Within the scope---

line maintenance

a)electric distribution

b)major tie line construction

c)system upgrade

d)emergency services

Within competitive markets---

billing services

e)meter reading

f)conservation services

We point out that both billing services and meter reading are critical functions that should be provided by private interests, particularly with functional unbundling.

5. Should the Department pursue legislation to (1) define the rights and obligations of the new distribution companies, and (2) define or increase the department's authority to establish Distribution Company rights and obligations? If so, what should be the content of the proposed legislation? ---- Our response to both questions is yes, particularly under functional unbundling where a system must be set up to monitor affiliate transactions. The

content of the proposed legislation should be directed at the consequences of unfair dealings between affiliates including and up to divestiture and legal sanctions.

#### Basic Service

Under the Departments two alternative scenarios, it is our opinion that basic service should be provided only for those customers who cannot obtain power in the open market and customers whose supplier fails to provide generation service. In that case, the Distribution Company by default becomes the supplier of last resort and the rate for basic service must be based upon the PE spot market price (Alternative No. 1). To allow the Distribution Company to "shop" for supply will simply put market power back into the hands of the Distribution Company. Additionally, we believe that "passive" customers should not be supplied with basic service as this will also put market power back into the hands of the Distribution Company. We are of the opinion that initially 60% of customers may be classified as "passive" when the market opens up. With a block of load as significant as that represented by the "passive" customer there is a potential for PE price manipulation through signals given between the Distribution Company and its affiliate Generator. To avoid any market power and/or PE manipulation we suggest that the "passive" customers be divided into a number of power blocks to be competitively bid for. Passive customers would then have the choice of either accepting the low bid from their supplier or requesting their supplier to use PE pricing.

#### Transition and BECo Proxy Price

APS agrees that unbundled rates in 1997 will benefit the customer to transition into full retail access, but only if a 1997 pilot program is put in place. We do not agree with the BECo method of unbundling. The BECo proposal sends the wrong market price signal. The advocacy of this model adds no value to the process and can be construed as a competitive market price for which it is not. The proxy New England Market Price Index ("NEMPI") is far from a competitive market price in reality, it is a dispatch of unit "cost" at the margin which is reflective of what utility companies report as their purchase fuel price and unit heat rates with some operating cost add ons. And, use of the highest cost unit does not represent the averaging of costs, a concept which is equivalent to shared savings. That shared savings represents system costs and probably would more closely resemble a market clearing price for the region. However, it should be understood that as more power is imported into New England via bilateral arrangements even the average price of the NEPOOL units would be priced higher than market. It is those bilateral price agreements that in fact represent the



effective price for power at the margin. The Department's unbundled price could be set by suppliers and buyers through negotiations while the utility can readily unbundle its price by netting out the generation price from its established tariff rates for transmission and distribution plus any applicable allowed surcharge. Indeed, if the Department believes it needs a proxy price marker to represent generation, then it could peg the proxy price against the open market price of fuel in the generation fuel mix. To truly benefit the customers, the unbundled rates must be based upon actual cost of service for transmission and distribution in addition to the provisional stranded cost tariff we suggested. Once actual COS tariffs are established customers will then be able to accurately estimate their cost for electricity in 1998.

#### Stranded Costs

We believe that since so much is at stake there is a real possibility of much gamesmanship being employed in this area. There are bona fide studies which question the magnitude of the stranded cost estimates. Utility reluctance to discuss sale of its generation assets leads to the opposite conclusion about the magnitude of strandable assets. Our assessment of FERC-1 forms for the largest utilities in the Commonwealth does not support the exaggerated claims of utility concerns. APS believes the Department should establish a provisional stranded cost tariff (suggest 1.0 cent/kwh) which would be subject to retroactive adjustment once a final determination of stranded investments is established as a result of a full Department review. We do accept the 10 year levelized pay back period, although we are concerned that cross subsidization will occur, that stranded costs will be front end loaded and that the true value of assets will be understated since they are not netted out for all assets. Due to uncertainties in determining the market values for generation assets, we agree the Department should consider bi-annual or even annual true-ups over a number of years. The customer has already been paying off all of the assets and clearly should be the beneficiary of a total asset evaluation. The amortization over 10 years should be straight line in nature to allow customers a measurable savings in the early years as well as the later years. (No front end loading)

#### Performance Based Regulation

We also ascribe to a price cap and we would suggest a railroad-style price cap for the

Distribution Company since it can more readily control input factors and achieve greater efficiency. The productivity factor would reflect expected productivity gains and is self adjusting. There would be no need for the P&X factors while the exogenous factors must be truly beyond the Distribution Company control. We also believe that price rules must be flushed out prior to unbundling in a one on one fashion. Agreement should be reached on the relationship of the input price index to costs and examples of exogenous costs should be listed.

Finally, we would like the Department to consider some items which were not included in its proposal. They are the following:

#### Pilot Program

APS strongly believes a full one year pilot program is essential for the success of the restructuring process. We believe that without a pilot program retail access will be delayed through customer confusion fed upon by utility scare tactics. None of us including the utilities are so knowledgeable that we will not learn from a one year pilot program. If anything, without a pilot program, we would expect "delaying" tactics based upon the premise that one needs to step carefully through a series of "phases" before restructuring takes place. Unbundling of rates, in and of itself, is not enough, since it does not provide economic benefit to the customer. The entire purpose of the restructuring process is to stimulate the economic viability of Massachusetts by lowering the cost of conducting business within the state. Why delay the most admirable purpose for a full year. We believe from our experience in New Hampshire that there will be "bugs" and that issues should be resolved through a pilot program prior to "opening day".

Thus, we believe that a Pilot Program is a necessity for it will help to properly educate and prepare all stakeholders to better understand the restructuring process. Let's not let a probable problem fester until "opening day", 1/1/98! We would suggest the Department consider the following proposal for a Pilot Program:

Commencement date---1/1/97

Include 20% of all customers - proportional to all classes

Random selection of volunteer customers by the Department

- Unbundled rates and generation prices established through contracts

- No dealings between Distribution and Generation Companies that are affiliates
- Stranded costs be divided 50/50 between customers and investors, subject to prudence reviews and subsequent market valuations. We also recommend that any stranded cost be capped at 1.0 cents per kwh through the transition year

There be no entry or exit fees

- The Distribution Company be fully accountable for making the Program work
- There be Departmental oversight and immediate remedied for non compliance